Internal Revenue Service

memorandum

WHEARD CC:TL:TS
TL-N-8626-89

date: DEC 1 1989

to: District Counsel, San Jose W:SJ
Attn: Steve Sibley

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [redacted]

This is in response to your request for tax litigation advice dated July 19, 1989, which was received by this office July 26, 1989.

ISSUE

Whether the failure of the partnership to allocate partnership contributions to a defined benefit pension plan (or liability for accrued pension contributions by the partnership), in proportion to each partner's share of every other relevant partnership item, violates the "same share" requirement of the small partnership exception to TEFRA pursuant to I.R.C. § 6231(a)(1)(A).

CONCLUSION

The reporting of pension contributions by the partnership which is listed on the partnership return and partner Form K-1s is subject to "same share" requirement for small partnerships. However, liability for accrued pension contributions by the partnership is not allocable to the partners until the contributions are paid and are thus not subject to the same share requirement. Since every partner's allocable share deductions attributable to pension contributions by the partnership is different than his share of other partnership items listed in Temp. Treas. Reg. § 301.6231(a)(3)-1T(a)(i) through (iv), the same share requirement for the small partnership exception to TEFRA was violated. Thus, the unified audit and litigation procedures of section 6231-6233 (TEFRA) apply.

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FACTS

For its [redacted] taxable year, an [redacted] partner partnership lists on Schedule 4-Other Current Liabilities $[redacted] as an accrued pension contribution (from the partnership) which is also shown as a current liability on Schedule L. In Schedule K, the partnership reports $[redacted] as "Other deductions"[1], including $[redacted] of "defined benefit plan" contributions, charitable deductions of $[redacted] and political contributions of [redacted] There is no other indication of who made the pension plan contributions other than the listing of these contributions under the heading of "Defined Benefit Plan". All items of income and deductions are allocated to the individual partners in proportion to their capital interest (which is the same as their stated profits and loss interest) except for pension plan contributions which are listed on the Form K-1s in amounts different from each partners profits and loss interests. The liability for the accrued $[redacted] pension contribution is not allocated as a deduction on any partner's Form K-1.

DISCUSSION

Section 6231(a)(1)(B) provides as relevant here:

> **(a) Definitions.**-For purposes of this subchapter-
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> . . .
>
> (B) Exception for small partnerships.-
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> (i) In general.-The term "partnership" shall not include any partnership if-
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> (I) such partnership has 10 or fewer partners each of whom is a natural person (other than a nonresident alien) or an estate, and

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[1] Schedule 4 of the return also shows $[redacted] of "Accured [sic] Pension Contribution" through the end of the taxable year [redacted]. There is no explanation of how this number may relate to the $[redacted] of contributions to the "defined Benefit Plan" in [redacted].

> (II) each partner's share of each partnership item is the same as his share of every other item. (emphasis supplied)

Temp. Treas. Reg. § 301.6231(a)(1)-1T(a)(3) provides with respect to the underlined language above as follows:

> **(3) "Same share."** The requirement of section 6231(a)(1)(B)(i)(II) is satisfied for a taxable year if during all periods within that taxable year each partner's share of each of the partnership items specified in § 301.6231(a)(3)-1T(a)(1)(i) through (iv) is the same as that partner's share of each of the other partnership items specified in that section during that period (even though the partner's share of all such specified partnership items changes from period to period within that taxable year. For purposes of section 6231(a)(1)(B)(i)(II) and this section, if each partner's share of each partnership item would be the same as his share of every other item but for allocations made under section 704(c) or allocations made under similar principles in accordance with applicable regulations the requirement of section 6231(a)(1)(B)(i)(II) shall be considered satisfied. Similarly, special basis adjustments pursuant to sections 754, 743 and 734 shall not be taken into account in determining whether the "same share" requirement is met.

Temp. Treas. Reg. § 301.6231(a)(3)-1T(a) provides in part as follows:

> **Partnership items.**-(a) In general. For purposes of subtitle F of the Internal Revenue Code of 1954, the following items which are required to be taken into account for the taxable year of the partnership under subtitle A of the Code are more appropriately determined at the partnership level than at the partner level and, therefore, are partnership items.
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> (1) The partnership's aggregate and each partner's share of each of the following:

> (i) Items of income, gain, loss, deduction, or credit of the partnership;
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> (ii) Expenditures by the partnership not deductible in computing its taxable income (for example, charitable contributions),
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> (iii) Items of the partnership which may be tax preference items under section 57(a) for any partner;
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> (iv) Income of the partnership exempt from tax;
>
> . . .

In Harrell v. Commissioner, 91 T.C. 242 (1988) and Z-Tron v. Commissioner, 91 T.C. 258 (1988), the Tax Court held that:

> For purposes of determining whether a partnership falls within the small partnership exception to the partnership audit and litigation provisions as provided in section 6231(a)(1)(B), the determination of whether "each partner's share of each partnership item is the same as his share of every other item" is to be made by examining the partnership return and K-1s, considering only those items reported for the year in issue.[2] (footnote supplied)

Thus, whether a violation of the same share requirement has occurred is determined by whether any partner's share of any partnership item (as defined by section 301.6231(a)(3)-1(a)(i) through (iv)) reported on each partner's form K-1 is different from the partner's share of any other item reported on his Form K-1. In the instant case, all items on the partners' Form K-1s are allocated according to that partner's share in the partnership except for "Defined Benefit Plan Contribution[s]" (hereafter referred to as pension plan). Furthermore, the liability for the accrued pension contribution by the partnership is not allocated at all. Thus, whether the same share

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[2] We are interpreting the Harrell/Z-Tron test consistently with our regulations. Thus, even if the same share requirement is violated under this test, the Service must then determine whether the apparent violation falls within an exception allowed by Temp. Treas. Reg. § 301.6231(a)(1)-1T(a)(3).

requirement is violated depends on whether the pension plan contribution by the partnership or partners, or the liability for the accrued pension contribution by the partnership falls within the four categories of partnership items which must be allocated on a same share basis.

PENSION CONTRIBUTION BY PARTNERSHIP:

There is no indication on the partnership return itself of where the $[redacted] of pension contributions came from other than the indication that the contributions were made to a "defined benefit plan". However, only employer contributions to a defined benefit plan are deductible. I.R.C. § 404(a).[3] Section 401(c)(4) provides that a partnership will be treated as the employer of each partner. Consequently, since the contributions are characterized as deductible payments to a defined benefit plan, it may be presumed that they were made by the partnership.

Such deductions must be allocated in accordance with each partner's profits interest in the partnership. Treas. Reg. § 404(e)-1A(f)(2) provides as follows:

> **(f) Partner's distributive share of contributions and deductions.**
>
> . . .
>
> (2) In the case of a defined benefit plan, a partner's distributive share of contributions on behalf of self-employed individuals and his distributive share of deductions allowed the partnership under section 404 for such contributions is determined in the same manner as his distributive share of partnership taxable income. See section 704, relating to the determination of the distributive share and regulations thereunder.

Since only payments made by the partnership under a "defined benefit plan" are deductible pursuant to section 404(a), the deduction for pension contributions is a "loss, deduction or credit of the partnership" within the meaning of Temp. Treas. Reg. § 301.6231(a)(3)-1T(a)(i). Consequently, it must be allocated in accordance with each partner's profits interest in order not to violate the same share requirement of the small partnership exception. Temp. Treas. Reg. § 301.6231(a)(1)-1T(a)(3); see also, Treas. Reg. § 1.404(e)-1A(f).

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[3] Only after tax contributions may be made by employees.

The only exception to this rule would be under section 301.6231(a)1T-(3)(a) which provides that special allocations under section 704(c) or "similar principles" are not a violation of the same share requirement. See footnote 2, supra. Although regulations existed which arguably allowed special allocations of defined benefit plan contributions not in conformity with a partner's profits interest for taxable years prior to 1986, these regulations have been rescinded for taxable years subsequent to September 3, 1982. See former I.R.C. § 401(j) and Treas. Reg. § 1.401(j).[4] Thus, for the present [redacted] taxable year, allocations of defined benefit plan contributions by the partnership must be in accordance with each partner's profits interest in the partnership pursuant to section 1.404(e)-1A(f)(2) without exception, in order to meet the same share requirement.

In summary, since the allocations of defined benefit pension plan contributions were not made in accordance with each partner's profits interest in the partnership, the same share requirement of the small partnership exception was violated and the provisions of section 6221 through 6233 (TEFRA) will apply to the audit and litigation of any partnership item adjustments.

Defined Contribution Plans

As a cautionary note, if the pension plan had been a defined contribution plan, disproportionate contributions on behalf of partners (including elective deferrals under a cash or deferred arrangement described in section 401(k)) and the corresponding deductions attributable to these contributions on behalf of a partner would be directly allocable to the partner according to the amount contributed on his behalf. See Treas. Reg. § 1.404(e)-1A(f)(1). Since the allocable deduction would not likely match the partner's profits interest, this would be an apparent violation of the same share requirement of the small partnership exception.

Section 301.6231(a)(1)-1T(a)(3), however, provides for an exception to the same share requirement when allocations are made under section 704(c) (relating to contributed property) or "similar principles". With respect to section 704, section 1.404(e)-1A(f)(1) specifically provides with respect to defined contribution plans that:

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[4] Section 401(j) was repealed for years after September 3, 1982 by TEFRA, P.L. 97-248; the regulation was formally withdrawn by T.D. 8115, Par. 11, 1987-1 C.B. 67.

> For the purposes of sections 702(8) and 704 . . . a partner's distributive share of deductions allowed the partnership under section 404 . . . is that portion of the deduction which is attributable to contributions made on his behalf under the plan.

Since this regulation specifically provides for an allocation under section 704 in the amount contributed on the partner's behalf, this type of allocation appears to satisfy the "section 704(c) or similar principles" test for the exception to the same share requirement. See footnote two, supra. If such issues are encountered, however, they should be coordinated with this office for a more extensive analysis.

ACCRUED PENSION LIABILITY BY PARTNERSHIP:

The $[redacted] liability for a pension plan contribution by the partnership was reported on the partnership return but was not allocated on the Form K-1s. Accrued liabilities for amounts payable to a pension plan are not deductible until paid. I.R.C. § 404(a). Thus, to the extent the $[redacted] represents accrued but unpaid amounts it is not deductible or allocable to the partners. Only the $[redacted] that was actually paid was deductible. Arguably, however, the nonallocation of the $[redacted] may mean that each partner was allocated [redacted] percent of a non-deductible expenditure which would differ from their percentage allocation of other items and, thus, also violate the same share requirement if an accrued but unpaid liability is an "expenditure" of the partnership which falls within one of the four categories of items considered above.

The only possible category that this accrual could fall under would be section 301.6231(a)(3)-1T(ii):

> (ii) Expenditures by the partnership not deductible in computing its taxable income (for example, charitable contributions),

It is our position that the above section was meant to apply only to items which would, of necessity, have to be allocated on the Form K-1s, e.g., charitable contributions which would be allocable to and deductible by the partners even though they are not deductible by the partnership. In the instant case charitable contributions by the partnership were in fact allocated according to the respective interests of the various partners.

On the other hand, an accrued pension liability by the partnership is neither deductible by the partnership nor the partners.[5] Since it was not deductible by anyone, it is arguably not even an "expenditure" within the meaning of the above regulations except to the extent payments were made on this accrued amount and reflected in the $[redacted] of actual contributions. The accrued liability itself, however, was not allocated to any partner. Allocation would be meaningless and confusing since the expenditure would not have any tax impact on any partner. Thus, the mere accrual of a pension plan liability, which in and of itself is not deductible, is not a "same share" item which must be allocated according to a partner's other same share items.

SUMMARY AND CONCLUSION

Since, under the Harrell/Z-Tron bright line test, there was an apparent violation of the same share test based on the partnership return and Form K-1s, the small partnership exception to TEFRA does not apply. On the partnership return a deduction was claimed for contributions to a "defined benefit plan", reflecting payments by the partnership to the pension fund in the amount of $[redacted]. Since the Form K-1s indicate that this amount was not allocated to the partners in proportion to their interest in other "same share" items, the same share requirement was violated. Since regulations allowing disproportionate allocations of such contributions have been repealed, no exception to the same share requirement exists with respect to defined benefit plans under section 301.6231(a)(1)-(3)(a) which provides that special allocations under section 704(c) or "similar principles" are not a violation of the same share requirement. See footnote 2, supra.

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[5] Pursuant to section 404(a), contributions may only be deducted when paid. The paid amount to a defined benefit plan must be allocated according to each partner's share of other relevant allocated items or a violation of the same share test will occur.

Please refer any questions on this matter to Bill Heard at FTS 566-3233.

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